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No. 78-1047

In the Supreme Court of the United States

OCTOBER TERM, 1978

GEORGE T. HORVAT, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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The question presented in this federal income tax case is whether petitioners are taxable on their wages despite their assignment of the wages to family trusts created by them.

The undisputed facts may be summarized as follows: In 1971, petitioners George T. Horvat and James J. Minesal[1] created two trusts and empowered the trustees to deal with the trust assets as they saw fit (Supp. App. 4;[2] Exs. 5-E, 6-F). Shortly after the creation of the trusts, petitioners executed similar documents purporting to convey irrevocably to their respective trusts the exclusive

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[1]"Petitioners" refers to George T. Horvat and James J. Minesal. Carol R. Horvat and Joyce Minesal are also petitioners because they filed joint income tax returns with their husbands for the years at issue.

[2]"Supp. App." refers to the Supplemental Appendix to the Petition.

use of their "lifetime services" and all of the resultant "earned remuneration from all and any outside source * * *." Petitioners also conveyed title to their personal residences and numerous articles of household furnishings to the trusts. In exchange, they each received all the units of beneficial ownership of the respective trusts (Supp. App. 4; Exs. 11-K, 12-L).

During 1971 and 1972, petitioners' employers paid them their wages directly in the usual fashion. However, on their income tax returns for 1971, petitioners included only the wages received by each of them prior to the purported conveyances of their lifetime services to the family trusts. For 1972, they also included certain fees they received for managerial services rendered to their respective family trusts (Supp. App. 5-6; Exs. 1-A to 4-D). On fiduciary income tax returns for the same years, petitioners' trusts reported the wages paid to them subsequent to their creation. In addition, each of the trusts claimed deductions for expenses incurred with respect to personal residences furnished petitioners, for trust management fees paid to petitioners, and for alleged employee business expenses incurred by petitioners (Supp. App. 6-7; Exs. 7-G to 10-J).

On audit, the Commissioner of Internal Revenue determined that petitioners' wages were taxable to them and not to the trusts and recomputed their taxable income. The Commissioner further determined that the managerial fees paid petitioners by their trusts represented a nontaxable return of corpus.[3] The Tax Court upheld the Commissioner's determinations (Supp. App. 7-9) and the court of appeals affirmed per curiam (Pet. App. 2-3).

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[3]In computing their tax liability, the Commissioner also allowed petitioners various itemized deductions.

1. The decision below correctly held that petitioners' attempted conveyances of their lifetime services to their respective family trusts were anticipatory assignments of income. This Court has long held that it is a basic principle of income taxation that income must be taxed on the person who earns it. *Lucas* v. *Earl*, 281 U.S. 111 (1930); *Commissioner* v. *Culbertson*, 337 U.S. 733, 739-740 (1949). It follows that one who earns income cannot avoid taxation by entering into a contractual arrangement whereby that income is assigned to some other entity or person. *United States* v. *Basye*, 410 U.S. 441 (1973).

Here, petitioners performed services for various employers during the period in question but attempted to avoid the federal income tax on their wages by assigning the income to the family trusts which they created. The Tax Court found, however, that the services performed and the business activity conducted were those of petitioners, and that petitioners, and not the family trusts, controlled the earning of the income. *American Savings Bank* v. *Commissioner*, 56 T.C. 828, 839 (1971); *Wesenberg* v. *Commissioner*, 69 T.C. 1005 (1978); Rev. Rul. 75-257, 1975-2 Cum. Bull. 251. Accordingly, the amounts paid petitioners in return for their personal services were taxable to them under the assignment of income principle. *Lucas* v. *Earl*, *supra*; *Helvering* v. *Horst*, 311 U.S. 112 (1940); *Harrison* v. *Schaffner*, 312 U.S. 579 (1941). See also *Comer* v. *Davis*, 107 F. 2d 355 (5th Cir. 1939).

2. There is no basis for petitioners' attack (Pet. 5-7) on the constitutionality of the assignment of income doctrine. As this Court has repeatedly held, the assignment of income principle is a "cornerstone" of the federal income tax system. *United States* v. *Basye*, *supra*, 410 U.S. at 450. Petitioners argue (Pet. 5) that the result below impairs in each instance the "inalienable right to implement, utilize and employ his personal property, namely, his labor, *e.g.*,

his life-time services." But the assignment of income doctrine does not interfere with petitioners' right to employ their personal services as they see fit. It only requires that they be taxed on the fruits of those services. See *Lucas* v. *Earl, supra,* 281 U.S. at 115; *Helvering* v. *Clifford,* 309 U.S. 331 (1940). Cf. *Gregory* v. *Helvering,* 293 U.S. 465 (1935); *Sakol* v. *Commissioner,* 574 F. 2d 694 (2d Cir.), cert. denied, No. 78-14 (Oct. 2, 1978).

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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Solicitor General

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